

US-Japan Trade Relations, Deregulation, and the Road Ahead

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Thank you very much.

As you are all aware, 1999 was a very lively year in trade. And most of you will also be aware that during 1999, the headlines did not always go to Japan. But while history sometimes proceeds ahead with shouting, publicity and street marches – as in our agreement with China or the WTO's Ministerial Conference in Seattle – at other times it proceeds more quietly but with implications equally important.

And that is the case, I maintain, in many of our negotiations on trade with Japan over the past two years. Next week, I will meet with my fellow co-chair, Deputy Foreign Minister Yoshiji Nogami, to discuss the third year of the so-called "Enhanced Initiative on Deregulation and Competition Policy" created by President Clinton and then-Prime Minister Hashimoto at the Denver G-8 Summit in 1997. It is a slightly dull name for a very exciting and fundamentally important medium for decisions: effecting Japan's transition to a new economic model at home; and, with this domestic transition, an accompanying transition to a less acrimonious trade relationship.

NEW CHALLENGES

Let me begin this discussion by looking backward. Over the past fifteen years, our trade relations with Japan have fundamentally changed. In the early and mid-1980s, trade policy focused essentially on managing Japanese imports in autos, steel and other manufacturing sectors. Today, we focus largely on the Japanese market.

This reflects changes in our economic relationship. Ten years ago, as we all well remember, Japan was booming and America was questioning its future. The speculation at home and abroad was that America had entered a period of long-term decline; and that Japan, with superior manufacturing processes and greater social stability, would inevitably take America's place as the world's leading economic power. American scholars were writing that Japan was "number one;" Japanese propagandists spoke of a Japan that could simply "say no." The prevailing state of mind was illustrated very well by Paul Kennedy in the hot book of 1987, *The Rise and Fall of the Great Powers*:

"The task facing American statesmen over the next decades is to recognize that broad trends are under way, and that there is a need to "manage" affairs so that the *relative* erosion of the United States position takes place smoothly and slowly."

Today, the tables have turned: the hot books are saying more or less the same thing about Japan's relative erosion and tamped-down prospects. And Americans are in a bit of a chest-thumping mood. I should say that this is a bit overdone, of course. We have reason to take pride in our work over the past decade on the budget, crime, scientific and technological progress and so forth. But we also have reason to be somewhat humble, in the face of the work remaining to address poverty, improve elementary and secondary education and many other social problems.

Likewise, Japan also retains the strengths its admirers pointed to ten years ago. Its manufacturing industries this year will produce almost as much as America's, in a country with half our population; and in an economy three fifths our size, Japanese firms, universities and government laboratories will invest as much money as we do in state-of-the-art research and development. Its entrepreneurs are among the world's most creative and adaptable – as we see, for example, in the success of Japanese popular culture, most recently the Pokemon empire, here in the U.S. In social terms, Japan remains the envy of the world: its citizens have the world's longest average lifespan; its students rate at the top of comparative international surveys; its streets are virtually free of crime.

But Japan's problems are also quite real: we are all well aware of their manifestation in a decade of low growth, financial difficulties and declining competitiveness. However, I do not believe these are insoluble problems. They arise from specific policies, which in turn reflect an outdated regulatory philosophy which both weakens existing companies and acts to prevent new ones from emerging. Trade policy and, specifically, our joint exercise in Deregulation and Competition can help Japan address this problem.

MACHINE AGE AND INFORMATION AGE

Our modern economy has drawn a great deal from the Japanese experience: the quality and productivity of American manufacturing today has built upon both the competitive spur Japanese companies have provided, and upon lessons drawn from Japanese factories.

Likewise, Japan can draw upon some of our experience as it takes up the problems it has experienced in the past decade.

Fundamentally, I believe that the roots of Japan's present problems lie in its slow transition from the age of machinery to the age of information. This in turn rests in the slow transition Japanese government officials and industrial leaders have made from an era in which government helped to control economic outcomes to one in which government provides the impartial and transparent regulation that can spur competition and innovation.

This is a field in which the United States can claim a genuine and long-term, although perhaps still partial, success. Much of our present economic buoyance derives, I believe, from a decision to leave the regulatory fields of the 1930s, 1940s and 1950s – in which government imposed controls over input, output and prices. This involved setting airline schedules, monitoring and controlling wages, telling farmers what to grow and setting rates for phone, power and similar services.

Our move away from this approach has been a slow, difficult, but also successful and bipartisan approach. It began with Alfred Kahn and the Carter Administration in energy, airlines and then telecommunications, and has since moved into many other industries. At the same time, we have progressively opened our economy to trade and competition. And as a result, many of our industries have become innovative in adopting new technologies and internationally much more competitive than they might have been ten years ago.

This set of reforms, however, has been premised not on a nihilistic premise that the best government is no government. Rather, it accepts an important and in some areas growing role for impartial regulation. Above all, as government turns decisions on prices and production levels to the private sector and the market, it can concentrate more effectively on areas which the market will not always offer solutions. These include areas such as environmental protection, public health and consumer protection, in which companies can at times find regulation burdensome but where regulation overall can promote efficiency, reduce waste, and offer us a combination of industrial growth and a rising quality of life.

This shift has been much slower in Japan. Japanese ministries remain far more concerned than their American counterparts about overseeing prices, production, competition (from domestic sources as well as from abroad) and economic outcomes. And their instinct is, of course, to protect the market share, revenue and employment of their industrial clients, whether in power, heavy industry, housing, telecommunications or natural resources. As a result, a Japanese company today pays more for everything it needs to run its business – from telephone calls, to energy bills, office rent, construction materials and beyond – than its foreign competitors.

This in turn creates a series of competitive problems. High phone rates mean that American's use their telecom network, by minutes of use, three times more than the Japanese. This means Japanese Internet usage is well below American levels, and that Japan begins to lag behind in the development of electronic commerce. More broadly speaking, the barriers to formation of new businesses with new ideas are higher in Japan; and existing companies are subtly weakened and become less able to compete with foreign firms. That in turn creates a cycle in which industries, unable to compete, lobby for protection – and once they receive it, feel no need to adapt to newer methods. So rather than encouraging companies to become leaner, more efficient and productive, the Japanese government is sheltering them from competition and creating a downward spiral.

This is the foundation, by the way, of Japanese activism on the anti-dumping issues: Japan's recent push for a revision of the U.S. anti-dumping law is at bottom a way to avoid restructuring of the steel industry. And you can see it in one sector after another – from traditional industries like construction, sawmills, agriculture, air services, to newer sectors such as nursing homes and fiber-optic cable.

U.S. TRADE POLICY

Ultimately Japan has to make the leap away from controlling outcomes to accepting competition. And Japan must make that decision itself, in its own interest. These are intimidating and difficult decisions which raise concerns about job tenure and family security and ultimately

social stability. The recent formation of an LDP party group to “study” the purported negative impact of regulatory change on small businesses is a case in point.

But these are, I hope, minority views; they are clearly incorrect views. The small business sector in Japan, for example, has benefitted more than any other from the space created by deregulation to date. And we can see the profound and positive effect of deregulation in many other areas. For example, Japan deregulated the cellular phone industry in 1993; and since then, cell phone prices have plunged, cell phone use has grown remarkably, with private investment in mobile service likely to reach \$14 billion this year. In real-life terms, this means millions of families and hundreds of thousands of businesses have gained convenience and efficiency.

This is an especially important story for our topic of trade policy. The fact is, our trade negotiations – so often portrayed as confrontations in which decisions to open markets are “victories” for the United States and “defeats” for Japan – are to the contrary procedures from which both sides can see results that create new opportunities for economic growth and technological progress. Because the fact is, the deregulation of Japan’s cell phone market is indeed the result of a trade agreement we reached in 1993.

In many other areas the story is the same. Financial services is an example, in which Japan’s successful implementation of the measures contained in our 1995 agreement on financial services complements Japan’s own liberalization under the “Big Bang.” Here, Japan has allowed new products – liberalizing securities derivatives, promoting a more vigorous asset-backed securities market, and introducing defined contribution pension plans. It has fostered competition, through liberalizing foreign exchange trading, easing registration for new companies, and allowing cross-entry among financial industry segments. And it has enhanced its accounting and disclosure standards. As time passes, full and effective regulatory reform of Japan’s financial markets will increase competition, help improve Japan’s long-term growth prospects, and contribute to a wider variety of investment opportunities for individuals and Japanese companies.

Our trade policies, of course, are rooted in the interests of the United States in a more open Japanese market. But the over-regulation, lack of competition and informal cartels we are attempting to address are also barriers between Japan and the information age; that is, between an era of slow growth and shrinking horizons and one of progress, optimism and returning strength. The matters of which I speak are not about “the U.S. versus Japan.” They are about “Japan versus the Future.” This fact, evident in the cellular phone anecdote, is clear on a much larger scale in the Enhanced Initiative on Deregulation and Competition Policy.

- In telecommunications, we agreed at the Birmingham Summit of 1998 on a set of measures to reduce interconnection costs, cut the cost of telephone service by hundreds of millions of dollars and speed up introduction of new telecommunications. To be sure, many beneficiaries will be American telecom companies hoping to sell new services in Japan; but every Japanese firm will also find itself more competitive, as costs decline and ability to use the Internet and other innovations rise. Today, because of NTT’s inefficiency and regulatory sway, Japanese businesses pay about 30 cents a minute to make a phone call from Tokyo to Osaka, whereas we pay about 10 cents a minute for a call from Washington to New York, an equivalent distance. Telecommunications costs in the

Information Age are the equivalent of the cost of oil in the Machine Age. The effect of NTT's monopoly power in today's economy is thus equivalent to Japan's saying it will insist on paying \$86 a barrel for crude oil, three times more than any of its competitors, just to feather the nest of one Japanese oil company. This is patently absurd. And the real-world effects are obvious, for example in the fact that only a sixth of Japanese households, compared to half of America's, are now linked to the Internet.

- In housing, we have agreed that Japan would adopt performance-based standards and testing requirements equivalent to those used around the world. These measures will open opportunities for American construction firms and suppliers; but they also reduce the cost of housing for families and building rental for businesses -- especially new ventures.
- And in energy, we want new competitors to enter the electricity generation market. We are working together to bring Japan from a monopoly to a competitive electrical market, eliminating market access barriers such as burdensome testing and inspection requirements and using performance-based standards rather than narrow, technical standards in energy. The goal is to reduce electricity costs in Japan to internationally-competitive levels. This means taking on the entrenched interests of incumbent electric utilities, no easy feat. Success here would present opportunities for American service providers, but will also result in lower barriers to entry for Japanese entrepreneurs, and greater competitiveness for existing Japanese companies.

In the weeks ahead, we will build on these achievements. Last October, Ambassador Foley presented a 45-page set of specific recommendations in these sectors and in many new areas. To cite some important and promising areas –

- We have asked that Japan adopt a “Big Bang” in telecommunications, analogous to the financial Big Bang of 1997. This would fundamentally reorient Japan's telecommunications policies, rewriting regulatory policies and encouraging the rapid introduction of new services.
- In the medical field, we have proposed a series of concrete measures that will make new pharmaceuticals available more quickly, speed approval of new medical devices and medicines, and make regulatory policy more transparent and predictable.
- In energy, we have offered ideas on incentives for competition, transparency in regulation and reducing barriers to investment and market entry.
- And we make further recommendations in a broad range of sectors and cross-cutting policy areas, from housing to financial services, distribution, competition policy and transparency.

ENTREPRENEURIAL SOCIETY

The work of deregulation may be complex. For some, it may even seem a little dull –

although not for some of our negotiating counterparts, who continue to see deregulation as a negotiating “concession” and perhaps a threat to some of the companies they oversee. But as these negotiators recognize – although in a way that is ultimately unhelpful to the old keiretsu or the monopolist like NTT – the effects of deregulation can be profound.

At the most immediate level, it means concrete and measurable benefits: lower costs for communications, office space and energy. Which in turn means more efficient companies and better returns on investment. Which in turn means improved opportunities for economic growth.

But a second effect may be still more important. That is, Ministries may remain reflexively suspicious of and conservative toward deregulation, to say nothing of Diet members who are looking to protect themselves and their patrons in any upcoming elections. But at the broader level Japan’s government has intellectually accepted its importance, saying that its goal is to replace a “bureaucrat-led culture” with an entrepreneurial society. Trade policy is a means to that end. This includes not only the Enhanced Initiative but the 37 agreements we have with Japan in fields from agriculture to insurance, high technology and manufacturing. The work underway in the Enhanced Initiative, therefore, has parallels with our work on a series of topics that could make up a separate speech, about the serious concerns we have with respect to flat glass, steel, insurance, and autos and auto parts.

Successful negotiations ultimately will help Japan create the non-discriminatory, transparent laws and regulations that ease trade and entrepreneurial activity, and encourage efficient allocation of investment. Thus they offer a chance to break the cycle of declining competitiveness and rising costs; to provide opportunities for people with ideas and new products to enter the market; to give Japanese consumers today a greater variety of goods and services at better prices; and to give Japan as a nation greater strength and confidence in the future.

CONCLUSION

In parallel with this, my hope is that the legacy of a decade of trade negotiations with Japan, beyond any specific agreement or export figure, will be a third transition in the trade relationship. Having moved from a focus on restricting Japanese imports to a focus on opening and deregulating the Japanese market, we can now perhaps begin to move again, from an era in which trade negotiations are considered largely adversarial to an era in which both sides see the benefits clearly and view themselves as benefitting from each other’s success.

This will not be an easy transition, because it is a transition of mind as well as policy. But if it does take root, and helps to guide the next set of trade negotiations with Japan, we will have done something of great importance.

That is, we will stabilize the overall political relationship, which is so important not only for our two countries but for the world. And we will at last enable this alliance to reach its full potential. As a creator of wealth for our countries and our neighbors. As a source of ideas, invention and science that will astonish the world. And as it has been for the past half century, as the strongest guarantee of lasting peace in the Asian-Pacific.

I'll leave it there, and I thank you very much.